December 21, 2017

Under Tax Reform, A New Landscape for Section 1031

Fast-Tracked Legislation, Once Signed, To Take Effect January 1

Congress passed the Republican tax reform bill, HR.1, the "Tax Cuts and Jobs Act" on Wednesday, December 20, 2017. The legislation, now on its way to President Trump to be signed and enacted, will take effect January 1, 2018.

- Section 1031 like-kind exchanges for real estate are preserved under current law.
- The role of t he Qualified Intermediary is preserved.
- Exchanges of personal property assets are eliminated.
- Several other provisions, including cuts to the corporate and individual tax rates, 100% immediate expensing for business assets, and provisions for pass-through businesses will affect Qualified Intermediaries, exchange clients, investors, businesses, and multiple industries.

The President is certain to sign the legislation, but the bill is not yet officially law. To avoid mandatory spending cuts in 2018, the "PAYGO" budget requirement must be waived before the law can be signed this year. If this hiccup is resolved in legislation being considered later this week, the President plans to sign before the end of 2017. Otherwise, observers expect President Trump to sign the legislation in the first days of January 2018.

The legislation moved quickly through both chambers, passing the House of Representatives on Tuesday afternoon, the Senate early Wednesday morning, and, because of a conflict with Senate rules, was passed again in the House by Wednesday afternoon. The bill passed less than two months after details of the proposal were released.

Impact on Section 1031

The legislation clearly preserves Section 1031 like-kind exchanges for real property and the role of the Qualified Intermediary. Exchanges for personal property, including heavy equipment, farm machinery, livestock, vehicles, aircraft, artwork and collectibles, franchises, and intangibles are eliminated under the new rules.

The new law is large and complex. FEA and others are still trying to understand and analyze the provisions impacting QIs and the like-kind exchange industry.

The Real Estate Roundtable, FEA's Real Estate Like-Kind Exchange Coalition partner, has begun to analyze the legislation's impact on the real estate industry. The Real Estate Roundtable has allowed FEA to share with our members their summary of the legislation's real estate provisions and a Q&A document exploring the effect of the 20% pass-through deduction on businesses, found below.

Section 1031 Transition Rules

Once signed, the legislation would take effect on January 1, 2018. The legislation permits a taxpayer to complete a personal property exchange as long as the taxpayer 1) begins the exchange in 2017, AND 2) EITHER i) sells the relinquished property by December 31, 2017, OR ii) acquires the replacement property by December 31, 2017. Note there is no reference to acquisition of replacement property by an EAT; the legislation specifies that the taxpayer must acquire the replacement property in order to fit within the transition rule.

Only real estate exchanges will qualify for tax-deferral treatment after January 1, 2018.

QIs with clients selling personal property should encourage them to contact their CPA to determine whether they can take advantage of any immediate expensing or increased Section 179 opportunities.

Uncertainties in the New Structure

The novelty, size, and complexity of the tax overhaul will create uncertainties and new conflicts that will take considerable time to understand. Among others, immediate questions for the QI industry and users of Section 1031 involve qualification of the new pass-through business deduction, such as whether QIs are considered "blacklisted" services; the methods for determining basis for the purposes of the 2.5% threshold rule; and the treatment of agricultural property in which there is minimal value to depreciable property. The Treasury Department is tasked with drafting new regulations to resolve any conflicts.

Going Forward

In this new tax landscape, FEA recommends QIs explore the new depreciation provisions and other issues tangential to Section 1031. Once the bill becomes law, FEA will provide more information and insight as details become evident. Look for subject matter and CE content in FEA communications, webinars, and at the FEA mid-year and annual conferences.

Thank You

The FEA is grateful to all those who supported the effort to preserve like-kind exchanges and our industry. Without the 24/7 leadership, strategy, and efforts of our lobbyist, Dave Franasiak; his team at Williams & Jensen; GAC co-chairs Brent Abrahm, Suzanne Goldstein Baker, and Max Hansen; FEA leaders; and the GAC and FEA members who provided resources, energy and efforts in Washington, D.C. and across the country, Section 1031 would have been a complete casualty of tax reform. The preservation of Section 1031 and the role of the QI today stands in stark contrast to our prospects in 2014, when the Camp Draft proposed complete repeal of like-kind exchanges.

It was then that FEA began building relationships with our coalition partners at a time when many of the 100+ associations that ultimately came to advocate for Section 1031 were unaware that like-kind exchanges mattered to their members.

There is no single act, decision, or person that got us here. Our success is pinned on everything we've done and everyone who did it. This was an incredible team effort for which we should be proud and grateful.

Resources for the "Tax Cuts and Jobs Act"

- Full Legislative Text of H. R. 1
- Q&A: 20% Pass-Through Implications *
- Summary of Real Estate Provisions *

*Provided thanks to The Real Estate Roundtable

Federation of Exchange Accommodators

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